競爭事務委員會
COMPETITION COMMISSION

通訊事務管理局
COMMUNICATIONS AUTHORITY

Revised Draft Guideline on
The Merger Rule

30 March 2015

Contents

Guideline on the Merger Rule

*This Guideline is jointly issued by the Competition Commission (the "**Commission**") and the Communications Authority (the "**CA**") under section 17 of Schedule 7 to the Competition Ordinance (Cap 619) (the "**Ordinance**").*

While the Commission is the principal competition authority responsible for enforcing the Ordinance, it has concurrent jurisdiction with the CA in respect of the anti-competitive conduct of certain undertakings operating in the telecommunications and broadcasting sectors.[1] Unless stated otherwise, where a matter relates to conduct falling within this concurrent jurisdiction, references in this Guideline to the Commission also apply to the CA.

*This Guideline sets out how the Commission intends to interpret and give effect to the Merger Rule in the Ordinance. This Guideline is not however a substitute for the Ordinance and does not have binding legal effect. The Competition Tribunal (the "**Tribunal**") and other courts are responsible ultimately for interpreting the Ordinance. The Commission's interpretation of the Ordinance does not bind them. The application of this Guideline may, therefore, need to be modified in light of the case law of the courts.*

This Guideline describes the general approach which the Commission intends to apply to the topics covered in the Guideline. The approach described will be adapted, as appropriate, to the facts and circumstances of the matter.

[1] The relevant undertakings are specified in section 159(1) of the Ordinance. These are licensees under the Telecommunications Ordinance (Cap 106)(the "**TO**") or the Broadcasting Ordinance (Cap 562)(the "**BO**"), other persons whose activities require them to be licensed under the TO or the BO, or persons who have been exempted from the TO or from specified provisions of the TO pursuant to section 39 of the TO.

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1 Introduction

1.1 Section 3 of Schedule 7 to the Ordinance provides that an undertaking[2] must not, directly or indirectly, carry out a merger that has, or is likely to have, the effect of substantially lessening competition in Hong Kong (the "**Merger Rule**"). Section 4 of Schedule 7 to the Ordinance provides that, *at present, the Merger Rule only applies where an undertaking that directly or indirectly holds a "carrier licence" within the meaning of the Telecommunications Ordinance (Cap. 106) ("**TO**") is involved in a merger.*[3] Given the restricted application of the Merger Rule to mergers involving at least one carrier licensee, examples given in this Guideline are generally related to telecommunications.

1.2 In accordance with section 17 of Schedule 7 to the Ordinance, this Guideline indicates the manner in which the Commission expects to interpret and give effect to the provisions under the Ordinance relating to the Merger Rule, including, in particular:

(a) the manner in which the Commission will determine whether or not a merger has, or would be likely to have, the effect of substantially lessening competition in Hong Kong;

(b) the manner in which the Commission will determine whether or not a merger would fall within the exclusion referred to in section 8(1) of Schedule 7 to the Ordinance; and

(c) the manner and form in which the Commission should be notified of any merger.

1.3 There is no requirement to notify the Commission of a merger or a proposed merger under the Ordinance. However, the Commission may use its powers to investigate a merger and take the necessary action to ensure compliance with the Merger Rule. As such, it may be in the interest of the parties to a proposed merger that would fall within the scope of the Merger Rule to approach the Commission to discuss the transaction and seek informal advice (which would not be binding on the Commission) on the

[2] Section 2(1) of the Ordinance provides that undertaking means "*any entity, regardless of its legal status or the way in which it is financed, engaged in economic activity, and includes a natural person engaged in economic activity*". For a discussion of the concept of undertaking, see the *Guideline on the First Conduct Rule.*

[3] "Carrier licence" is defined in section 2(1) of the TO as *"a licence issued for the establishment or maintenance of a telecommunications network for carrying communications to or from the public between fixed locations, between moving locations or between fixed locations and moving locations, within Hong Kong, or between Hong Kong and places outside Hong Kong, on a point-to-point, point-to-multipoint or broadcasting basis, such locations within Hong Kong being separated by unleased Government land, but does not include the licences listed in Schedule 1 [of the TO]".* See also Part 2 of this Guideline for details.

transaction on a confidential basis. Pursuant to section 60 of the Ordinance, parties to a merger or proposed merger may propose Commitments to the Commission to address its concerns about a possible contravention of the Merger Rule. Where applicable, parties to a merger or proposed merger may under section 11 of Schedule 7 to the Ordinance also apply to the Commission for a decision whether the merger or proposed merger is excluded from the application of the Merger Rule.

2 Scope of the Merger Rule

What constitutes a merger?

2.1 This part of the Guideline explains the types of transactions that would constitute a merger under the Ordinance. In general, transactions that involve the merging of two or more undertakings into one, the acquisition of one (or part of an) undertaking by another, the forming of a joint venture and the acquisition of assets by one undertaking from another may potentially be a merger which needs to be examined under the Merger Rule. Section 4 of Schedule 1 to the Ordinance indicates that where an agreement or conduct amounts to a merger under the Ordinance, the First and Second Conduct Rules do not apply.

2.2 Section 3(1) of Schedule 7 to the Ordinance sets out the Merger Rule: *"An undertaking must not, directly or indirectly, carry out a merger that has, or is likely to have, the effect of substantially lessening competition in Hong Kong."*

2.3 A merger takes place if:

(a) two or more undertakings previously independent of each other cease to be independent of each other (section 3(2)(a) of Schedule 7 to the Ordinance);

(b) one or more persons or other undertakings acquire direct or indirect control of the whole or part of one or more other undertakings. The creation of a joint venture to perform, on a lasting basis, all the functions of an autonomous economic entity also constitutes a merger within this category (sections 3(2)(b) and 3(4) of Schedule 7 to the Ordinance); or

(c) an acquisition by one undertaking (the "**acquiring undertaking**") of the whole or part of the assets, including goodwill, of another undertaking (the "**acquired undertaking**") results in the acquiring undertaking being in a position to replace the acquired undertaking, or to substantially replace the acquired undertaking, in

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the business or in part of the business concerned in which the acquired undertaking was engaged immediately before the acquisition (sections 3(2)(c) and 3(3) of Schedule 7 to the Ordinance).

Mergers between previously independent undertakings

2.4 A merger takes place when, for example, two or more previously independent undertakings amalgamate into a new undertaking and cease to exist as separate legal entities. A merger may also occur where, in the absence of a legal merger, there is a *de facto* amalgamation of the undertakings concerned into a single economic unit, by establishing a permanent, single economic management. Other relevant factors for the determination of a *de facto* merger may include internal profit and loss compensation or a revenue distribution between the various entities within the group, and their joint liability or external risk sharing. The *de facto* amalgamation may be solely based on contractual arrangements, but it can also be reinforced by cross-shareholdings between the undertakings forming the economic unit.

Acquisition of control

2.5 A merger may also take place when one or more persons or other undertakings acquire direct or indirect control of the whole or part of one or more other undertakings. Under section 5(1) of Schedule 7 to the Ordinance, control, whether solely or jointly, in relation to an undertaking, is to be regarded as existing if, by reason of rights, contracts or any other means, or any combination of rights, contracts or other means, decisive influence is capable of being exercised with regard to the activities of the undertaking and, in particular, by:

(a) ownership of, or the right to use all or part of, the assets of an undertaking; or
(b) rights or contracts which enable decisive influence to be exercised with regard to the composition, voting or decisions of any governing body of an undertaking.

2.6 Section 5(2) of Schedule 7 to the Ordinance indicates that control is acquired by any person or other undertaking if the person or undertaking:

(a) becomes a holder of the rights or contracts, or entitled to use the other means, referred to in paragraph 2.5 above; or
(b) although not becoming such a holder or entitled to use those other means, acquires the power to exercise the rights derived from them.

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2.7 "Decisive influence" in paragraph 2.5 refers to the power to determine decisions (including the making or vetoing of such decisions) relating to the strategic commercial behaviour of an undertaking, such as the budget, the business plan, major investments or the appointment of senior management. In determining whether decisive influence is capable of being exercised, section 5(3) of Schedule 7 to the Ordinance states that regard must be had to all the circumstances of the case and not solely to the legal effect of any instrument, deed, transfer, assignment or other act done or made. Control may therefore occur on a legal or *de facto* basis.

Joint ventures

2.8 The creation of a joint venture to perform, on a lasting basis, all the functions of an autonomous economic entity constitutes a merger for the purposes of the Ordinance. Joint ventures which satisfy these requirements bring about a lasting change in the structure of the undertakings concerned and the relevant market.

2.9 Performing all the functions of an autonomous economic entity means that a joint venture must operate on a market and perform the functions normally carried out by an undertaking operating on that market. In order to do so, the joint venture must have a management dedicated to its day-to-day operations and access to sufficient resources, including finance, staff and assets (tangible and intangible), in order to conduct on a lasting basis its business activities within the area provided for in the joint venture agreement.

2.10 A joint venture does not perform all the functions of an autonomous economic entity if it only takes over one specific function within the parent companies' business activities without access to or presence on the market. This is the case, for example, for joint ventures limited to research and development or production. Such joint ventures are auxiliary to their parent companies' business activities. This is also the case where a joint venture is essentially limited to the distribution or sales of its parent companies' products and, therefore, acts principally as a sales agency. However, the fact that a joint venture makes use of the distribution network or outlet of one or more of its parent companies normally will not disqualify it from being considered as performing all the functions of an autonomous economic entity, as long as the parent companies are acting only as agents of the joint venture.

2.11 The joint venture must be intended to operate for a sufficiently long period to bring about a lasting change in the structure of the undertakings concerned. The fact that the parent companies commit to the joint venture the resources to carry out all the functions of an autonomous economic entity normally demonstrates that this is the case. However, joint ventures for a short finite duration are unlikely to be considered as creating such a

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lasting change. For example, a joint venture established for a specific project which does not include ongoing operational activities is unlikely to be viewed as a merger under the Ordinance. In addition, where a joint venture's core activities depend on a third party's decision which at the time of establishment remains outstanding (e.g. a tender award, the grant of a licence, etc.), it remains unclear whether the joint venture would become operational at all. Thus, at that stage the joint venture cannot be considered to perform autonomous economic functions on a lasting basis.

2.12 The Commission will also take into account the presence of the joint venture's parent companies in upstream or downstream markets. Where a substantial proportion of sales or purchases between the parents and the joint venture are likely for a lengthy period and are not on an arm's length basis, the joint venture is likely to be viewed as lacking sufficient economic autonomy in its operational activities.

Acquisition of assets

2.13 A merger may also take place by way of acquisition of the whole or part of the assets (as opposed to control) of an undertaking, provided that such acquisition results in the acquiring undertaking being in a position to replace, or substantially replace, the acquired undertaking in the business or in part of the business concerned, i.e. the business which the acquired undertaking was engaged in immediately before the acquisition. The assets which are being acquired in a merger may include both tangible assets (such as network, equipment, customer base, etc) and intangible assets (such as licences, rights, permissions, etc).

Merger Rule applies only to a merger involving a carrier licensee

2.14 The Merger Rule does not apply to every merger that meets the requirements of section 3 of Schedule 7 to the Ordinance. Section 4 of Schedule 7 specifically limits the application of the Merger Rule to the following:

(a) in a case involving amalgamation of undertakings, one or more of the undertakings participating in the merger holds a carrier licence or, directly or indirectly, controls an undertaking that holds a carrier licence;

(b) in a case involving acquisition of control of undertakings, the undertaking or the person or persons acquiring control or the undertaking in which control is acquired holds a carrier licence or, directly or indirectly, controls an undertaking that holds a carrier licence; or

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(c) in a case involving acquisition of assets, the acquiring undertaking or the acquired undertaking holds a carrier licence or, directly or indirectly, controls an undertaking that holds a carrier licence, and the relevant business conducted by the acquired undertaking immediately before the acquisition was conducted under a carrier licence.

2.15 In short, under section 4 of Schedule 7 to the Ordinance, the Merger Rule only applies where an undertaking that directly or indirectly holds a carrier licence is involved in a merger.

Transactions which are unlikely to raise competition concerns under the Merger Rule

2.16 Subject to the specific facts of the case, the Commission will normally take the view that the following transactions are unlikely to give rise to competition concerns:

(a) the acquisition of securities in a carrier licensee or in an undertaking which directly or indirectly controls a carrier licensee on a temporary basis by:
   (i) an authorized institution within the meaning of the Banking Ordinance (Cap. 155);
   (ii) an insurer who is authorized within the meaning of the Insurance Companies Ordinance (Cap. 41); or
   (iii) an exchange participant within the meaning of the Securities and Futures Ordinance (Cap. 571), or a person licensed or exempt to carry on a business in dealing in securities or securities margin financing under Part V of that Ordinance,

   if:
   (iv) the securities are acquired with a view to reselling them; and
   (v) the authorized institution, insurer, or exchange participant, registered institution or licensed corporation (as the case may be):
      (A) does not exercise voting rights in the securities; or
      (B) exercises the voting rights in the securities only with a view to preparing the disposal of all or part of the securities of the carrier licensee or the undertaking which directly or indirectly controls a carrier licensee (as the case may be), or of the assets of the carrier licensee or the undertaking which directly or indirectly controls a carrier licensee (as the case may be), and the disposal takes place:
         (I) within one year of the date of the acquisition; or

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(II) where the Commission is satisfied that the disposal is not reasonably possible within one year of the date of the acquisition, within such further period as the Commission considers appropriate;

(b) the acquisition of control of a carrier licensee or an undertaking which directly or indirectly controls a carrier licensee by the liquidators and receivers of the carrier licensee or the undertaking which directly or indirectly controls a carrier licensee (as the case may be) by virtue of their offices;

(c) the acquisition of holdings in a carrier licensee or in an undertaking which directly or indirectly controls a carrier licensee by a financial holding company. In this context, the notion of a "financial holding company" means a company whose sole object is to acquire and manage holdings in other undertakings and to turn them into profit without involving itself directly or indirectly in the management of those undertakings;

(d) a charge[4] over securities[5] in a carrier licensee or an undertaking which directly or indirectly controls a carrier licensee to:

(i) an authorized institution within the meaning of the Banking Ordinance (Cap. 155);

if:

(ii) the securities are charged pursuant to a deed or instrument with a view to securing a loan to the chargor, the carrier licensee or the undertaking which directly or indirectly controls a carrier licensee or otherwise, and

(iii) the authorized institution,

(A) does not exercise voting rights in the securities or has not given notice in writing to the chargor under the charge of an intention to exercise the right to vote attaching to such voting shares; or

(B) having given notice in writing to the chargor under the charge of an intention to exercise the right to vote attaching to such voting shares, exercise the right to vote only to maintain the full value of the security and without directly or indirectly affecting or influencing the competitive conduct of the carrier licensee or the undertaking which directly or indirectly controls a carrier licensee (as the case may be).

[4] "Charge" means (i) a debenture within the meaning of the Companies Ordinance (Cap. 622); (ii) a mortgage; (iii) a bill of sale; (iv) a lien; or (v) any document, under or pursuant to which a business or any assets thereof are charged as security by the chargor for the payment of money or the performance of an obligation, and includes an equitable charge.

[5] "Securities" has the meaning assigned to it by section 1 of Part 1 in Schedule 1 to the Securities and Futures Ordinance (Cap. 571).

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2.17 In general, the Commission will not be concerned about changes in the control of undertakings which are not of a lasting nature. Changes in control of undertakings which are purely transitory in nature, for example, a transaction that is short-term and is only an intermediary step among several operations occurring in succession are unlikely to have any effect on competition in the relevant market.

Ancillary restrictions

2.18 A merger transaction can involve the acceptance of restrictions which go beyond the merger agreement itself. Such restrictions could include non-compete covenants, licences for intellectual property or purchase and supply agreements.

2.19 Where the restrictions are directly related and necessary to the implementation of the merger agreement, they will be treated as ancillary restrictions and will be assessed as part of the merger transaction under the Merger Rule. On the other hand, where the restrictions are not directly related and necessary in this sense, they will fall to be assessed under the First and/or Second Conduct Rules.

3 Competition Assessment

General overview

3.1 Merger and acquisition activities do not necessarily raise competition concerns under the Merger Rule. Indeed, mergers can be normal business activities without competition consequences that perform an important function in the efficient operation of the economy. They may allow firms to achieve efficiencies such as economies of scale or scope, synergies and risk spreading. Although some mergers may lessen competition to an extent, concerns under the Merger Rule are unlikely to arise where there are sufficient competitive constraints on the merged entity that will discipline its post-merger commercial behaviour.

3.2 However, some mergers may have the effect of changing the structure of the market in such a way that it diminishes market participants' incentives to compete. Where such an effect is likely to substantially lessen competition, the transaction will contravene the Merger Rule.

3.3 The promotion of competition in the context of the Ordinance has an economic objective to increase economic efficiencies and, ultimately, consumer welfare (typically in the form of lower prices, higher output, wider choice, better quality or more innovation). Given the economic objective, a meaningful economic framework of analysis for the assessment of a merger is needed.

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3.4 It follows that an assessment of the competitive effects of a merger requires:

(a) an identification of the relevant market(s); and
(b) an assessment of whether the transaction has, or is likely to have, the effect of substantially lessening competition in the identified market(s).

3.5 However, the two issues identified above are not distinct and separate aspects of the analysis since many of the factors affecting the identification of the relevant market(s) will also be relevant to the assessment of the state of competition within the identified market(s).

Market definition

3.6 Proper examination of the competitive effects of a merger rests on a sound understanding of the competitive constraints under which the merged entity will operate. The scope of those constraints, if any, is identified through a market definition analysis since it offers an insight into the sources of competition to the merging parties and the alternatives available to customers. It is important to emphasise that market definition is not an end in itself. It is a framework for analysing the direct competitive pressures faced by the merged entity.

3.7 The Commission will focus its assessment on whether a merger has, or will likely to have, the effect of substantially lessening competition in the relevant market(s). The definition of a relevant market for the practical enforcement of the Merger Rule involves the same basic approach employed in defining relevant markets in other contexts.

3.8 The delimitation of relevant market(s) has two basic dimensions: product (or service) scope and geographic scope. Please refer to the *Guideline on the Second Conduct Rule* for an explanation of the Commission's methodology for identifying the scope of the relevant product and geographic markets for all purposes under the Ordinance.

3.9 In general, when assessing the potential competitive impact of a merger, the main competitive concern is whether the merger has resulted or is likely to result in an increase in prices above the prevailing level after the merger[6].

[6] The reference to "increase in prices" is used as a short hand reference that includes also references to adverse impact on other parameters of competition in the market such as output, product quality, product variety, and innovation.

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3.10 For the purpose of merger analysis, market definition focuses attention on the areas of overlap in the merging parties' activities. This is particularly the case in differentiated product markets, where the merging parties' products or services may not be identical, but may still be substitutes for each other. In this context, the analytical discipline of market definition is helpful in identifying the extent of the immediate competitive interaction between the parties' products. Once the overlap in the merging parties' products or services has been identified, along with the "market" in which those products or services compete, the Commission can focus attention on the competitive assessment.

3.11 The approach to market definition set out in the *Guideline on the Second Conduct Rule* is a conceptual framework and is not intended to be applied mechanically. The Commission will look at the evidence which is relevant to the case in question (and, to an extent, will be constrained by the evidence available and the time reasonably available during the merger process to review the evidence). In particular it may be clear in certain cases that, although there is potentially more than one market definition, the merger would not give rise to a substantial lessening of competition based on any sensible market definition. In such cases, it will not normally be necessary to establish a final position on which of the potential market definitions is correct. It may for example be possible to conclude that even on the narrowest plausible market definition no substantial lessening of competition would result from the merger.

3.12 In relation to telecommunications markets specifically, they may be characterised by dynamic and rapid technological changes. In such circumstances, market boundaries are not likely to remain constant.

Indicative safe harbours

3.13 The objective of specifying "safe harbours" is to give guidance as to which mergers are unlikely to substantially lessen competition. They provide a screening device and are not intended as a replacement for a case-by-case analysis. If a merger falls outside the safe harbour thresholds, it is not necessarily an indication that the transaction would substantially lessen competition in a market for the purposes of the Merger Rule. It merely indicates that further inquiry may be made by the Commission to assess the extent of any potential anti-competitive effects. The Commission may conclude after further investigation that the transaction would not be likely to substantially lessen competition. In general, for a horizontal merger where the post-merger combined market share of the parties to the transaction is 40% or more, it is likely that the merger will raise competition concerns and the Commission is likely to make a detailed investigation of the transaction.

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3.14 The Commission has identified two safe harbour measures that it intends to apply concurrently, thereby expanding the effective coverage of the indicative safe harbour mechanism beyond a single measure. A merger that meets either one of the safe harbour measures will fall within the safe harbour. The application of these safe harbour measures requires identification of the relevant market and the respective market shares of the players in the relevant market.

3.15 The first safe harbour measure is based on concentration ratios. These ratios measure aggregate market shares of the leading firms in the relevant market. The Commission intends to apply a test based on a four-firm concentration ratio. If the post-merger combined market share of the four (or fewer) largest firms ("**CR4**") in the relevant market is less than 75%, and the merged firm has a market share of less than 40%, the Commission takes the view that it is unlikely that there will be a need to carry out a detailed investigation or to intervene. Where the CR4 is 75% or more, the Commission is unlikely to investigate the transaction if the combined market share of the merged entity is less than 15% of the relevant market.

3.16 The second safe harbour measure is based on the Herfindahl-Hirschman Index ("**HHI**"). The HHI measures market concentration. It is calculated by adding together the squares of the market shares of all the firms operating in the market. The increase in the HHI resulting from the merger is calculated by subtracting the pre-merger index from the expected value of the HHI following the merger, the difference being known as the "delta." Both the absolute level of the HHI and the expected change resulting from the merger can provide an indication of whether a merger is likely to raise competition concerns.

3.17 In respect of the application of HHI, any market with a post-merger HHI of less than 1,000 will be regarded as unconcentrated. Mergers resulting in unconcentrated markets are unlikely to result in a substantial lessening of competition and normally require no further investigation.

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3.18 Markets with a post-merger HHI of between 1,000 and 1,800 will be regarded as moderately concentrated. Mergers producing an increase in the HHI of less than 100 in these markets are unlikely to result in a substantial lessening of competition and normally require no further investigation. However, mergers producing an increase in the HHI of more than 100 potentially raise competition concerns and will normally require further investigation.

3.19 Markets with a post-merger HHI of more than 1,800 will be regarded as highly concentrated. Mergers producing an increase in the HHI of less than 50 are unlikely to substantially lessen competition, even in a highly concentrated market. Mergers producing an increase of more than 50 in the HHI will potentially raise competitive concerns and will normally require further investigation.

3.20 These two safe harbours are indicative in nature. While the Commission is unlikely to further assess any mergers which fall below these thresholds, it does not categorically rule out intervention. Occasionally, such mergers may still raise competition concerns, for example where it involves a vertically integrated firm with market power in a related upstream or downstream market.

Assessment of the level of competition after a merger

3.21 Where the safe harbour thresholds are not satisfied, or the Commission otherwise considers that a detailed investigation into the merger is necessary, the next issue is to assess the level of competition following the merger.

3.22 Market structure comprises those factors that influence the level of competition in a market. Competition in a market is influenced by the structural features of the market such as market shares, market concentration, barriers to entry, vertical integration, buying power and import competition. A merger, by its nature, will change the market structure.

3.23 For non-structural factors, one that may be particularly relevant is the "strategic behaviour" of firms. Such strategic behaviour is directed at altering the market structure itself (for example, by raising barriers to entry) and in this sense goes beyond the normal competitive rivalry between firms.

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3.24 Accordingly, the Commission will take into account structural factors and non-structural factors such as strategic behaviour, when assessing the level of competition in a market and the likely effect the merger would have on that level of competition. In this way, the Merger Rule ensures that market structures which are likely to harm competition are not created.

Relevant analytical issues

3.25 Before entering into a discussion of the particular factors that the Commission will generally take into account in analysing the competitive effects of a merger, several analytical issues that are considered relevant to any merger analysis are discussed below.

Protection of the process, not the competitor

3.26 Competition in a market is essentially a dynamic process rather than a static situation where particular conduct may competitively disadvantage a particular competitor at a particular time. Competition by its very nature is a deliberate and at times ruthless process as competitors jockey for position. This is as true for mergers as it is for any other forms of market conduct.

3.27 That a particular competitor may be injured or competitively disadvantaged at a particular time does not necessarily lessen competition in a market, let alone substantially (the test of substantiality is discussed below). Indeed, it may be the epitome of the competitive process. As part of the process, disadvantaged competitors would be expected to respond to any competitive initiatives in the market. It is only when they are unable to respond as a direct consequence of the merger in question that concerns arise about the effects on the competitive process in a market.

Substantiality test – creation or enhancement of market power

3.28 The relevant test to be applied for the Merger Rule is whether the merger has, or is likely to have, the effect of substantially lessening competition in Hong Kong. The focus of the Commission's assessment is the likely competitive effects the merger has on the relevant market(s) in Hong Kong.

3.29 The term "substantial" is useful in avoiding application of the regime to situations where there are limited effects on the competitive process, such as may occur when there is day-to-day injury to individual competitors but the competitive process within the relevant market remains strong.

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3.30 The Commission will generally interpret a substantial lessening of competition by reference to the creation or enhancement of market power. A merger creates or enhances market power if it is likely to encourage one or more firms to raise price, reduce output, limit innovation, or otherwise harm consumers as a result of diminished competitive constraints or incentives.

3.31 In assessing a merger, the Commission will consider whether a merger creates or enhances market power. If there is a reasonable likelihood that prices in the relevant market will be maintained at a significantly greater level than would be the case in the absence of the merger, or where competitive outcomes would be otherwise distorted such as reduction in consumer choice, product quality or innovation in a relevant market, the Commission will consider that the merger substantially lessens competition in contravention of the Merger Rule.

Exercise of market power: unilateral and coordinated effects

3.32 A horizontal merger may lessen competition in two ways, in terms of creating unilateral effects and coordinated effects. A single merger may raise both types of effects.

3.33 *Unilateral effects* may arise in a merger when one firm merges with a competitor that previously provided a competitive constraint, allowing the merged firm profitably to raise prices or to reduce output or otherwise exercise market power it has gained, even given the expected responses of other market participants to the resulting change in market conditions.

3.34 *Coordinated effects* take place where the merger increases, enables or encourages post-merger coordinated interaction among the firms in the market. Coordinated interaction involves conduct by multiple firms that is profitable for each of them only as a result of the accommodating reactions of others. These reactions can blunt a firm's incentive to offer customers better deals by undercutting the extent to which such a move would win business away from rivals. They also can enhance a firm's incentive to raise prices, by assuaging the fear that such a move would lose customers to rivals. Coordinated interaction can involve the explicit negotiation of a common understanding of how firms will compete or refrain from competing – such conduct typically would also contravene the First Conduct Rule. Coordinated interaction alternatively can involve parallel accommodating conduct not pursuant to any prior understanding, which can still have the effect of dampening competition. Conditions conducive to coordination typically include concentrated markets, product homogeneity and transparent pricing.

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3.35 Coordinated effects can be disrupted by the presence of a "maverick" firm, a firm which has the economic incentive not to follow coordinated action. A firm is more likely to be a "maverick" if it has excess capacity (a feature of some telecommunications markets) and low incremental costs (thus making it profitable to charge low prices). It is a feature of network industries, including telecommunications, that services which are provided over networks tend to have low incremental costs. However, excess capacity amongst the remaining coordinated firms may be used as an effective weapon to "punish" a "maverick" firm.

With-and-without test

3.36 In assessing whether competition is likely to be substantially lessened by a merger, the Commission will usually employ an analytical tool called the "with-and-without" test. That is, the level of competition that is likely to exist in a market with the merger will be assessed and compared with the level of competition that is likely to exist in the market without the merger. The competitive situation without the merger is referred to as "the counterfactual". This analysis will be applied prospectively, that is, future competition will be assessed with and without the merger.

3.37 In most cases, the best guide to the appropriate counterfactual will be prevailing conditions of competition, as this may provide a reliable indicator of future competition without the merger. However, the Commission may need to take into account likely and imminent changes in the structure of competition in order to reflect as accurately as possible the nature of rivalry without the merger. For example, in cases where one of the parties is failing, pre-merger conditions of competition might not prevail even if the merger were prohibited. The Commission will not, however, apply the "with-and-without" test relying on agreements or conduct that would contravene the Ordinance: only lawful prospective options are relevant.

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Market share and market concentration

3.38 Market share refers to the share of a market that a particular firm has. It is usually measured in terms of sales volume or revenue. The latter is a particularly useful indicator of market shares in markets characterised by product differentiation and brand loyalty. In telecommunications markets, the number of subscribers, call minutes, data volume, etc. are obvious measures of sales volume. Transmission capacity or bandwidth may be a relevant form of volume measurement when the transmission service is largely commoditised or undifferentiated. Capacity or reserves may also be useful as a measure of market share in markets where there is volatility in market shares measured in terms of sales volume or revenue.

3.39 Market concentration refers to the degree to which a market is composed of a small number of large firms or made up of many small firms. In general, an unconcentrated market may be more competitive than a concentrated market. A merger which results in the merged entity holding large market share and increases the level of market concentration may lessen the level of competition.

3.40 High market shares and concentration levels as a result of a merger are generally necessary but not sufficient conditions for the creation or enhancement of market power that may lead to a contravention of the Merger Rule. On the other hand, a merged firm with only small market share in a relatively unconcentrated market would not normally be able to exercise market power and thus is less likely to contravene the Merger Rule.

3.41 As information on market shares and concentration levels is more readily obtainable for a pre-merger situation, thresholds on market shares and concentration levels are simple means of screening-out mergers that are not likely to lessen competition (see paragraphs 3.13 to 3.20). Post-merger information by its nature is prospective and may be based on a number of assumptions on future market structure. As a starting point, post-merger market shares and concentration ratios will be estimated on the basis of historic sales patterns and trends. This is likely to be more informative than considering market shares at a single point in time (which might hide the dynamic nature of the market). The Commission will then consider any submissions as to how these trends may vary, such as through the introduction of new, innovative services or technology.

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3.42 The actual volume or revenue measure used for market share calculation will depend on the characteristics of the product in question. The choice of measure may also be constrained by the availability of reliable data. For example, in telecommunications, retail revenues, call minutes or numbers of subscribers are possible measures for measuring market share of telecommunications operators.[7]

Prices and profit margins

3.43 The Commission will consider the likelihood of a merger resulting in the merged firm being able to significantly and sustainably increase prices or profit margins.

3.44 Sustained price increases above competitive levels are the most visible sign that the merged firm has increased its market power and there is a substantial lessening of competition in the market. The price increase may be used to protect inefficient operations rather than to accumulate excess profits. Another possibility is that a merger, instead of increasing prices, may prevent prices from falling to the competitive level by forestalling entry such that profit margins are preserved or even increased.

3.45 Cost reductions which are claimed to result from the merger may not result in lower prices to consumers because the savings may accrue as increased profits.

Relevant matters that may be considered in determining whether competition is substantially lessened

3.46 Section 6 of Schedule 7 to the Ordinance provides a non-exhaustive list of the relevant matters that may be taken into account in determining whether a merger has, or is likely to have, the effect of substantially lessening competition in Hong Kong:

"(a) the extent of competition from competitors outside Hong Kong;

(b) whether the acquired undertaking, or part of the acquired undertaking, has failed or is likely to fail in the near future;

[7] Reference may be made to the Final Decision of the Communications Authority in April 2014, on the Application for Prior Consent under Section 7P of the Telecommunications Ordinance in respect of the Proposed Acquisition of CSL New World Mobility Limited by HKT Limited (http://www.coms-auth.hk/filemanager/statement/en/upload/270/decision_20140502_e.pdf), where the CA looked at market shares in the retail mobile telecommunications services market from different perspectives, including market share by subscribers (which was further sub-divided into market share of all subscribers and market share of 3G/4G subscribers), and market share by revenue (which was further subdivided into voice revenue, non-voice revenue, total revenue minus handsets, and total retail revenue). In that Decision, assessing market shares from different perspectives enabled the CA to have a more all rounded view of the competitive position of the mobile network operators in the market identified.

(c) *the extent to which substitutes are available or are likely to be available in the market;*
(d) *the existence and height of any barriers to entry into the market;*
(e) *whether the merger would result in the removal of an effective and vigorous competitor;*
(f) *the degree of countervailing power in the market; and*
(g) *the nature and extent of change and innovation in the market."*

Extent of competition from competitors outside Hong Kong

3.47 In an open economy such as Hong Kong, competition from competitors outside Hong Kong, so called "import competition", can play an important role in restraining the exercise of market power. An example of import competition in the telecommunications industry is the provision of international telephone services to Hong Kong users by service providers operating outside Hong Kong. In considering the effectiveness of import competition as a restraint to the exercise of market power, the capacity of supply of overseas suppliers and speed of entry into the domestic market have to be considered.

3.48 In most segments of the telecommunications industry where physical presence in Hong Kong is necessary for the supply of services, the threat of import competition may not be relevant.

Failing firms

3.49 At first glance, one would expect that the acquisition of a failing or failed firm would not substantially lessen competition. In some instances this may be the case. However, there may be circumstances where the acquisition of a failing firm may substantially lessen competition.

3.50 It is considered that the acquisition of a failing or failed firm would be unlikely to substantially lessen competition in cases where:

(a) the firm is likely to experience commercial failure, if the firm has not already failed;
(b) without the acquisition, the assets of the firm will exit the market; and
(c) the firm has made unsuccessful, good-faith efforts to elicit reasonable alternative offers to acquire its assets that would keep those assets in the market and would pose a less severe danger to competition.

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3.51 If all three conditions are satisfied, then subject to the considerations in the following paragraph, the competitive effects of the firm being acquired by the acquirer are likely to be no worse than if the assets were allowed to exit the market, consistent with the "with-and-without" test discussed in paragraph 3.36. A competitive influence that would otherwise have been removed by failure is to be removed by acquisition. Thus, in the absence of other considerations, the acquisition would be unlikely to cause concerns under the Merger Rule.

3.52 One issue that may arise in this scenario, however, is the distribution of the failing firm's customer base if this base is significant in terms of market share. If the assets exited the market, the distribution of the failing firm's customer base among the remaining market participants would be determined by market forces, whereas an acquisition would tend to deliver those customers to the acquiring firm thus increasing its market share.

Extent to which substitutes are available

3.53 In considering the extent to which substitutes are available in the market, both existing and potential substitutes from the supply side and the demand side will be included. In considering the extent to which substitutes are available, the Commission may also consider the price elasticity of supply of the firms in the market post-merger. Unless the producers of the substitutes are able to increase supply to meet the demand of customers of the merged firm who intend to switch suppliers in response to a material price increase of the merged firm, the existence of substitutes in the market would not be an effective restraint to the exercise of market power by the merged firm. It may therefore be necessary to consider the relative supply capacity of the firms in the market after the merger, as well as the costs of capacity expansion. If the merged firm ends up controlling a majority of the capacity in the market, other firms in the market may not be able to provide much competitive restraint.

Barriers to entry or expansion

3.54 An important factor influencing the level of competition in a market is the height of barriers to entry/expansion of rivals, for the threat of entry/expansion of rivals is often viewed as the ultimate regulator of competitive conduct even if the merged firm currently has a high market share.

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3.55 Barriers to entry/expansion of rivals are essentially any market features that prevent an efficient prospective new entrant from entering the market or an existing player in the market from expanding in the market, or otherwise place them at a significant competitive disadvantage to incumbents. They may arise from a variety of sources, from regulatory restrictions to economic factors or from the conduct of the merging parties to the behaviour of third parties. Barriers to entry/expansion of rivals can reduce the prospects of competitive entry by new entrants or expansion of rivals, with the consequence that incumbents are less constrained by the threat of new entry or expansion of rivals to behaving competitively.

3.56 Recognised barriers to entry for the purposes of the Merger Rule include sunk costs, economies of scale and scope, network effects, strategic behaviour, product differentiation and brand loyalty, essential facilities and regulatory or legal barriers. Sunk costs and economies of scale and scope are particular features of telecommunications markets and other network-based markets. These structural barriers to entry can be contrasted with strategic behaviour as a barrier to entry, which will be discussed separately. Paragraphs 3.57 to 3.70 set out the Commission's approach to barriers to entry in the context of the Merger Rule with particular relevance to the telecommunications sector. Additional guidance on barriers to entry is provided in the *Guideline on the Second Conduct Rule* in the context of assessing substantial market power.

Barriers to entry – structural

3.57 Market entry in certain markets such as telecommunications typically involves significant sunk costs. Sunk costs are the costs of acquiring capital and other assets that:

(a) are uniquely incurred in entering the market and supplying the services in question;
(b) cannot be economically recouped within a short period of time; and
(c) once incurred, cannot easily be physically recovered and redeployed in another market.

3.58 Because of their nature, sunk costs create entry risks which increase with the significance of the costs. In turn, significant risks can create significant barriers to entry. The extent of sunk costs depends on a number of factors such as the proportion of capital involved, the requirements for advertising and promotion to create brand awareness, etc.

3.59 An example of significant sunk costs typically incurred in telecommunications is the cost of network roll-out (e.g. installing radio base stations, core network equipment, antennae, etc), a cost which cannot be recovered or easily recouped if the new entrant decides to exit the market within a short period. Accordingly, firms considering entry into the market with significant sunk costs must assess the profitability of entry on the basis of long-term participation in the market until the sunk capital and assets are economically depreciated. In certain circumstances, the cost of providing a new service may also involve costs which cannot be recovered or easily recouped.

3.60 With economies of scale and scope, average costs fall as the supply of services or range of services supplied increases respectively. Falling costs are likely to increase barriers to entry where there are minimum efficient scales for entry.

3.61 When combined with sunk costs and excess capacity, the effect of economies of scale in particular can create significant barriers to entry. Having sunk the infrastructure costs, there are incentives for incumbents in situations of excess capacity to reap the economies of scale to drop prices and gain necessary revenue flows. Even without any strategic purpose, such action can significantly deter new entrants (as discussed below, such action may indeed be accompanied with that strategy in mind).

3.62 Closely related to economies of scale are network effects. By its nature, telecommunications is essentially a network industry and a feature of networks is that they generate network effects (or externalities). Network effects arise when the value a consumer places on connecting to a network (as measured by the price one is willing to pay) depends on the number of others already connected to it. They are a form of economies of scale, but on the demand side.

3.63 Network effects generate "positive feedback" or advantages for incumbents whereby the bigger networks get bigger (and, on the negative side, the weak get weaker). Unrestrained positive feedback can result in the market "tipping" in favour of one competitor and a "winner-takes-all" market outcome. Particularly when combined with economies of scale on the supply side, network effects can create significant barriers to entry.

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3.64 Reputational barriers established by brand loyalty to incumbents (which may in themselves be a strategic barrier to entry) may add to the sunk costs faced by a new entrant in the form of advertising and promotion costs. The ongoing investment in advertising and promotion that is required to maintain a differentiated product will accentuate sunk costs. The nature and extent of the barriers created by brand loyalty and product differentiation can be conceptualised as an investment in sunk costs that is required to shift demand to an unknown brand and create a new differentiated market niche.

3.65 In some cases, entry to a market might require the use of an essential facility, an asset or infrastructure where: (1) access to it is indispensable in order to compete in the market; and (2) duplication of the facility is impossible or extremely difficult owing to physical, economic or legal constraints, or is highly undesirable for reasons of public policy.

3.66 Denial of access to essential facilities is thus capable of constituting a significant barrier to entry, particularly in the telecommunications industry where access to customers in certain situations has to go through a "bottleneck" or "essential facility". However, the potential for essential facilities to act as a barrier to entry can be alleviated by effective regulatory regimes for the interconnection and sharing of bottleneck facilities.[8]

Barriers to entry – strategic behaviour

3.67 The most important non-structural factor, when assessing barriers to entry, is what is generally referred to as strategic behaviour. This is broadly defined as any actions by a firm to alter the market structure, and so alter the conditions and levels of competition (for example, by raising barriers to entry). As such, it goes beyond the normal competitive rivalry between firms.

3.68 Strategic advantages can arise where incumbent firms have advantages over new entrants because of their established position. This is known as the first-mover advantage. Strategic (first mover) advantages are available to incumbent firms because they are already established in the market and therefore might enjoy advantages over recent or potential new entrants. These advantages could be used by incumbents to raise the barriers to entry, and can involve strategic behaviour designed to deter entry to the market.

[8] The regulation of such telecommunications facilities is separately overseen by the CA as a sector regulator under the TO.

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3.69 An example of strategic behaviour which would raise the barriers to entry is where an incumbent firm decides to build excess capacity so as to send credible signals to potential entrants that it could profitably (with economies of scale and low marginal costs) push prices down to levels such that new entrants would not earn sufficient revenue to cover their sunk costs.

3.70 An incumbent firm can act strategically to create barriers to entry which can be as effective as any traditional structural barriers to entry described in the previous section. These are sometimes described as strategically erected barriers to entry.

Removal of a close competitor

3.71 By its nature, a horizontal merger will usually remove a competitor from the market. However, the resulting higher market shares of the merged entity and increased concentration levels are generally necessary, but not sufficient, conditions for the creation or enhancement of market power that may lead to a contravention of the Merger Rule. A factor which may provide guidance on whether market power is created or enhanced is whether the merger results in the removal of a close competitor. The higher the degree of substitutability between the merging firms' products, the higher the degree of closeness of competition between them, and the more likely it is that the merging firms will raise prices significantly. For example, a merger between two undertakings offering products which a substantial number of customers regard as their first and second choices could generate a significant price increase.

3.72 Beyond removing a close competitor, the merger may create a market structure which is conducive to coordinated action or tacit collusion. Effective and vigorous competitors, otherwise known in this context as "maverick" firms, serve to undermine attempts to coordinate conduct in a market. The role of mavericks has been discussed above in respect of the unilateral and coordinated exercise of market power.

Buying power or countervailing power

3.73 Market power can be exercised on the demand-side by monopsonists or groups of buyers acting together to depress prices below their competitive levels. The effects are comparable to those associated with the exercise of market power on the supply-side. Additional guidance on countervailing buyer power is provided in the *Guideline on the Second Conduct Rule* in the context of assessing substantial market power.

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3.74 Market power on the buying side is relevant in two principal ways under the Merger Rule. First, it may make a finding of substantial lessening of competition less likely if customers can use their negotiating strength to limit price rises. Second, the existence of buyer power may contribute to a finding of a substantial lessening of competition where the merging firms purchase similar products and the merger would create or strengthen post-merger buyer power.

3.75 Generally, the market power (sometimes referred to as buying or bargaining power) must be supported by a credible threat to bypass the supplier if no acceptable deal can be bargained. This may not always be the case in telecommunications when the existence of alternative suppliers may be constrained by the presence of bottleneck or essential facilities, particularly the network to which the originating or terminating customers are directly connected. While it may not be common in telecommunications, should it occur, the Commission will assess the effects of any demand-side market power in an analogous fashion to assessing supply-side market power.

Nature and extent of change and innovation in the market

3.76 The Ordinance indicates that the nature and extent of change and innovation in the market may be a relevant factor when determining whether a merger is or likely to have the effect of substantially lessening competition. While price competition is a central concern of merger control, non-price competition, and in particular reductions in innovation levels, may also be a source of legitimate concern. In general, the analysis of innovation issues involves the application of the "with-and-without test" described at paragraph 3.36, that is to compare pre and post-merger innovation levels and, if there is any material change, to assess the effect on competition of the posited reduction in innovation.

Additional relevant matters for vertical mergers

3.77 A vertical merger is the integration of two functional levels in the supply chain. Vertical mergers can often be pro-competitive as it allows firms to generate efficiencies, particularly through savings on transaction costs and the achievement of economies of scale.

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3.78 In industries with high sunk costs such as telecommunications, vertical mergers can also help reduce the risk of investment. For example, a provider of telecommunications services carried over someone else's network may wish to integrate with upstream network operation in order to reduce the risk of being held captive by the network owner.

3.79 More fundamentally, a vertical merger is less likely to be anti-competitive than a horizontal merger because in a vertical merger, the two merging firms will generally supply complementary products whereas in a horizontal merger the parties will supply substitute products in the same market.

3.80 There are two main possible theories of harm for unilateral effects under a vertical merger. Competitors at a downstream functional level (e.g. retail telecommunications service providers) may have to rely on the supply of an input at an upstream level (e.g. reliance on an upstream network provider to carry their downstream services). Where a vertical merger takes place, the merged entity may have the ability and incentive to foreclose downstream non-integrated rivals' access to the supply of such an input. This is known as input foreclosure theory of harm. The other theory of harm, known as customer foreclosure, may result from a vertical merger when a supplier integrates with an important customer in the downstream market. Such downstream presence of the merged entity may enable it to foreclose access to a sufficient customer base by its actual or potential rivals in the upstream market (the input market) thereby reducing their ability or incentive to compete.

3.81 Where there is market power at one functional level, there may be incentives to leverage that market power into the vertically-related market for anti-competitive purposes.

3.82 The leverage, for example, may take the form of refusing access to an essential facility that the merged firm has recently acquired control of through the merger so as to foreclose competition in a downstream market where it faces competition. Alternatively, access may be supplied only on discriminatory or competitively disadvantageous terms (either actual discrimination or concealed discrimination), thus raising its downstream rivals' costs.

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3.83 To profitably engage in a foreclosure strategy, one must have market power in the relevant market from which to leverage the strategy. Otherwise downstream competitors relying on the upstream facilities firms would simply bypass the facilities and seek better terms elsewhere in the upstream market (unless the market power is exercised through coordinated action). It may also be relevant to ask in this connection whether the input in question represents a material proportion of the total costs of the final product and whether cost increases are likely to be passed on in whole or in part to purchasers of the final product. Anti-competitive foreclosure concerns are more likely to arise if the answer to one or both of these questions is affirmative.

3.84 Accordingly, in assessing a vertical merger for its likely anti-competitive effects, the Commission will particularly inquire as to whether:

(a) there is market power at one or more of the functional levels involved in the merger;
(b) there are incentives to leverage that market power into the upstream or downstream market with the purpose of lessening or foreclosing competition in that market (i.e. where the merged firm operates in a competitive upstream or downstream market);
(c) the market power is likely to be leveraged (for example, where raising rivals costs in downstream markets through discriminatory access pricing would be profitable and would lessen competition); and
(d) the effect is likely to substantially lessen competition in that market.

3.85 A vertical merger may also bring about coordinated effects. For example, a vertical merger may increase the degree of symmetry between firms active in the market. This may enhance the likelihood of coordination by making it easier for the firms in the market to achieve a common understanding on the terms of coordination.

4 Exclusions and Exemptions

4.1 The Ordinance provides for certain exclusions and exemptions from the Merger Rule, which are explained in this part of the Guideline.

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Exclusion – outweighing economic efficiencies

4.2 Section 8(1) of Schedule 7 to the Ordinance provides that the Merger Rule does not apply to a merger if the economic efficiencies that arise or may arise from the merger outweigh the adverse effects caused by any lessening of competition in Hong Kong. Section 8(2) of Schedule 7 to the Ordinance indicates that the undertaking(s) claiming the benefit of this exclusion has/have the burden of proving the claim.

4.3 Analysing whether the economic efficiencies that arise or may arise from the merger outweigh the adverse effects involves a net economic benefit analysis. The aim of the analysis is to isolate and ascertain the objective benefits created by the merger and the economic importance of such efficiencies. The efficiencies are not assessed from the subjective viewpoint of the parties.

4.4 There are generally three types of economic efficiencies:

(a) productive efficiency, which is achieved where a firm produces the goods and services that it offers to consumers at the lowest cost;
(b) allocative efficiency, which is achieved where resources in the economy are allocated to their highest valued uses (i.e. those that provide the greatest benefit relative to costs); and
(c) dynamic efficiency, which is achieved through an ongoing process of introducing new technologies and products in response to changes in consumer preferences and production techniques.

4.5 In relation to productive and dynamic efficiencies, competition seeks to achieve these efficiencies organically or internally within a firm. However, mergers also have a potential to generate significant efficiencies by permitting a better utilisation of existing assets and the realisation of economies of scale and scope which would not have been available (or available to the same extent) to either firm without the merger.

4.6 Efficiencies generated through a merger can enhance the merged firm's ability and incentive to compete. For example, merger generated efficiencies may enhance competition by permitting two ineffective high-cost competitors to become one effective low-cost competitor. If the efficiency gains attributable to a merger would transform the merged entity into a more vigorous competitor, competition in the market as a whole would be increased rather than lessened by the merger.

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4.7 Furthermore, in markets with conditions conducive to coordinated conduct, an efficiency-enhancing merger can undermine those conditions by increasing the incentive for a "maverick" to break from the pack or, indeed, by creating a new "maverick" firm.

4.8 Any undertaking claiming the benefit of the outweighing economic efficiency exclusion must show that the efficiency gains occur as a direct result of the merger. Further, the efficiencies must be clearly identified and verified. It must also be demonstrated that the efficiencies will be achieved (or achieved to a similar extent) by the merger and would be unlikely to have been achieved (or achieved to a similar extent) without the merger (for example, internal re-organisation) or by another means having less significant anti-competitive effects. But the less restrictive alternative must be something that is likely to be practical for firms in the market and not merely a theoretical possibility.

4.9 Efficiencies are often difficult to verify and quantify, in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms. Moreover, efficiencies projected reasonably and in good faith by the merging firms may not be realised. Therefore, undertakings must do more than assert the claimed efficiencies. They must be able to demonstrate that the efficiencies are timely, likely and sufficient to outweigh the adverse effects caused by any lessening of competition. Efficiency claims must be substantiated by the merging parties so that the Commission can verify by reasonable means:

(a) the likelihood and magnitude of each claimed efficiency;
(b) how and when each efficiency would be achieved;
(c) how each efficiency would enhance the merged firm's ability and incentive to compete;
(d) why each efficiency would be merger-specific; and
(e) how the efficiencies would outweigh the adverse effects caused by any lessening of competition.

4.10 Certain types of efficiencies are more likely to be identifiable and more substantial than others. In general, cost reductions ought to be capable of verification without excessive difficulty. For example, efficiencies resulting from the shifting of telecommunications traffic from formerly separately owned networks onto the one network may result in a reduction in marginal costs which are merger-specific, identifiable and quantifiably substantial. Other efficiencies, such as those relating to research and development, are

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potentially substantial but are generally less verifiable. Others, such as those relating to procurement, management, or capital cost, are less likely to be merger-specific or substantial, or may not be as identifiable.

4.11 The Ordinance provides for a mechanism for parties to a merger to apply for a decision of the Commission as to whether the merger is excluded from the Merger Rule on the basis that the economic efficiencies that arise or may arise from the merger outweigh the adverse effects caused by any lessening of competition. The procedures for making such an application are explained in paragraphs 5.16 to 5.24.

Public Policy Exemption

4.12 Pursuant to section 9 of Schedule 7 to the Ordinance, the Chief Executive in Council may, by order published in the Gazette, exempt a specified merger or proposed merger from the application of the Merger Rule if he or she is satisfied that there are exceptional and compelling reasons of public policy for doing so. Such an exemption may be subject to any conditions or limitations that the Chief Executive in Council considers appropriate.

Exclusion from the merger rule for statutory bodies or specified persons and persons engaged in specified activities

4.13 The Merger Rule does not apply to a statutory body as defined in section 2(1) of the Ordinance, unless it is specified in a regulation made by the Chief Executive in Council under section 5 of the Ordinance that, *inter alia*, the Merger Rule applies to the statutory body, or to the statutory body to the extent that it is engaged in an activity specified in the regulation under section 3 of the Ordinance.

4.14 The Merger Rule also does not apply to a person specified in a regulation made by the Chief Executive in Council under section 5 of the Ordinance, which provides that, *inter alia*, the Merger Rule disapplies to such specified person, or to such specified person to the extent that the person is engaged in an activity specified in the regulation pursuant to section 4 of the Ordinance.

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5 Procedures and Enforcement

No requirement to notify a merger

5.1 There is no requirement to notify the Commission of a merger falling within the Merger Rule. The Commission will keep itself informed about merger activities for example by monitoring the media and/or through information or complaints from third parties, such as competitors, to bring transactions to its attention. Under section 7(1) of Schedule 7 to the Ordinance, the Commission may commence an investigation of a merger within 30 days after the day on which the Commission first became aware, or ought to have become aware, that the merger has taken place. As detailed in sections 99 and 100 and in Schedule 4 to the Ordinance, if the Commission, after carrying out an investigation, has reasonable cause to believe that a merger contravenes the Merger Rule, it may, within six months after the day on which the merger was completed or the Commission became aware of the merger (whichever is the later), bring proceedings in the Tribunal seeking orders to unwind the merger in relation to a completed merger. In relation to an anticipated merger, the Commission under section 97 to the Ordinance may also bring proceedings in the Tribunal seeking to stop the merger process.

5.2 As a merger may be subject to investigation by the Commission, and proceedings in the Tribunal (which has the power to effectively unwind a completed merger or stop the merger process in case of an anticipated merger), it may be in the interest of the parties to a merger to contact the Commission at an early stage to understand whether the Commission has any concerns about a proposed transaction. Such contacts in advance may enable the parties to identify any potential competition concerns and to address the issues in good time, as well as to minimise the risk that proceedings are brought by the Commission before the Tribunal.

5.3 Parties are therefore encouraged to contact the Commission at the earliest opportunity to discuss a proposed merger that falls within the Merger Rule, where they may seek the Commission's informal advice on the transaction. Parties will proceed at their own risks where they choose not to notify the Commission of a proposed merger in advance. Details of the procedures for seeking the informal advice from the Commission are provided at paragraphs 5.4 to 5.8 below.

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Voluntary notification of a proposed merger for informal advice

5.4 To assist merging parties and their advisers when planning mergers, the Commission is willing to provide informal advice on a proposed merger on a confidential basis. Since the advice would be given without the benefit of any third party views being made known to the Commission, the advice would not be binding on the Commission in any way. It would simply be a preliminary view of the Commission as to whether the proposed merger is likely to raise competition concerns. The advice would be confidential to the party requesting it and the Commission requests the party concerned (and its advisers) to agree not to publish the advice or to disclose it in any other way without the Commission's prior consent, whether or not the proposed merger has been made public or is completed.

5.5 There is no timetable for providing informal advice, but the Commission will try to deal with requests in an efficient and timely manner and within the parties' requested time frame, where that is possible.

5.6 Before deciding whether to submit a notification of a proposed merger for informal advice from the Commission, parties to a merger may apply the safe harbours set out in paragraphs 3.13 to 3.20 to self-assess whether the merger transaction in contemplation may potentially raise competition concerns. It should however be emphasised that meeting one or both of the safe harbour thresholds does not necessarily mean that the proposed transaction does not give rise to competition concerns. The Commission may still commence an investigation in appropriate circumstances. Parties considering application for informal advice are encouraged to contact the Commission at an early opportunity to discuss the content, timing and scope of information that they may be required to provide.

5.7 While the Commission does not wish to be entirely prescriptive as to what information it would require in this regard, it would expect parties to provide some evidence that either the heads of agreement, term sheet, or sale and purchase agreement are in place. Parties may make reference to the type of information listed in Form M[9], to the extent where it is applicable, when submitting their notification. The Commission may require the parties to provide additional information as necessary to enable it to conduct a review of the proposed merger.

[9] Form M is available at the CA's website (www.coms-auth.hk).

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5.8 After reviewing the information provided, the Commission will advise the parties requesting the advice whether the proposed merger is likely to give rise to concerns under the Merger Rule, on a non-binding and confidential basis. In the event that the Commission is of the view that the proposed merger may likely give rise to concerns under the Merger Rule, the Commission may commence an investigation if the parties intend to proceed with the merger nonetheless (see paragraphs 5.25 to 5.28). The parties concerned may wish to explore possibilities of offering Commitments to the Commission in return for the Commission not taking enforcement actions (see paragraphs 5.9 to 5.15), or assess whether there are justifiable circumstances for them to apply for a decision from the Commission that the merger is excluded from the Merger Rule (see paragraphs 5.16 to 5.24).

Acceptance of Commitments

5.9 Section 60 of the Ordinance provides that the Commission may accept from a person a Commitment to take any action or refrain from taking action that the Commission considers appropriate to address its concerns about a possible contravention of, *inter alia*, the Merger Rule, in return for the Commission's agreement not to commence an investigation or bring proceedings in the Tribunal, or to terminate any investigation or proceedings that has been commenced.

5.10 Section 60 thus provides for an opportunity to the parties to a merger to offer remedies to address the competition concerns that the Commission may identify in relation to a merger or proposed merger, in return for the Commission not taking, or ceasing, enforcement actions against them. Such circumstances may arise, for example, where parties to a proposed merger have notified the transaction to the Commission for an informal advice, and the Commission is of the view that the proposed merger raises certain competition concerns and intends to take further action were the proposed merger to proceed.

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5.11 In order for the Commission not to take, or to cease, enforcement actions, the remedies offered by the parties to a merger or proposed merger as Commitments should be able to eliminate or avoid the effect of substantially lessening competition in a relevant market that is, or is likely to be, brought about by the merger or proposed merger. The Commission will consider accepting both structural and/or behavioural remedies.

5.12 In general, structural remedies will be preferred by the Commission as they are more able to deal with the competition concerns identified at source, by re-establishing the structure of the market expected in the absence of the merger to restore the process of rivalry, and do not generally require ongoing monitoring activity. Behavioural remedies, on the other hand, are less likely to address competition concerns arising from a merger or a proposed merger as comprehensively as structural remedies, may result in distortions compared with a competitive market outcome, and are generally subject to the disadvantage of requiring ongoing monitoring and compliance activity.

5.13 Structural remedies could include divestment of part of the merged business through the disposal of assets or shares. Typically this might involve an overlapping business. The Commission would require the disposal to be made within a specified time limit.

5.14 In appropriate cases, behavioural remedies may be accepted where the Commission wishes to ensure that the merged entity does not behave in an anti-competitive way after the merger. For example, the parties may be required not to undertake a particular course of conduct made possible by the merger.

5.15 Under Schedule 2 to the Ordinance, before accepting a Commitment, the Commission must give notice of the proposed Commitment in any manner it considers appropriate to those that are considered likely to be affected by the merger and the proposed Commitment, allow at least a period of 15 days for representations to be submitted, and consider any representations that are made to the Commission. As required by section 64 of the Ordinance, any Commitment accepted by the Commission will be made public in the register of Commitments required to be established and maintained by the Commission. The Commission may also under sections 61 and 62 of the Ordinance, subject to a similar publication requirement, withdraw its acceptance of a Commitment in specified circumstances, accept a variation of the Commitment or a new Commitment in substitution for it, or release any person from a Commitment. The procedural requirements for the acceptance, withdrawal of acceptance, variation and release of Commitments are provided in Schedule 2 to the Ordinance.

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Decision that a merger is excluded

5.16 Pursuant to Part 5 of Schedule 7 to the Ordinance, parties to a merger or proposed merger may apply to the Commission for a decision as to whether or not the merger is, or the proposed merger would if completed be:

(a) excluded from the application of the Merger Rule by or as a result of section 8 of Schedule 7, i.e. if the economic efficiencies that arise or may arise from the merger outweigh the adverse effects caused by any lessening of competition (see paragraphs 4.2 to 4.11); or

(b) excluded from the application of Schedule 7 by virtue of section 3 (application to statutory bodies) or section 4 (application to specified persons and persons engaged in specified activities) of the Ordinance (see paragraphs 4.13 and 4.14) ("**Decision**").

Under section 164 of the Ordinance, a fee will be payable for making an application for Decision.[10]

5.17 If the Commission makes a Decision, the Commission may not take any action under the Ordinance unless the Decision is rescinded (section 15 of Schedule 7 to the Ordinance), or the merger as implemented is materially different from the proposed merger to which the Decision relates (section 14 of Schedule 7 to the Ordinance). The Decision by the Commission may include conditions or limitations subject to which it is to have effect including, in the case of a proposed merger, specifying a date by which the proposed merger must be completed. Pursuant to section 13 of Schedule 7 to the Ordinance, after the Commission has made a Decision, it must inform the applicant in writing of the Decision, the date of the Decision and the reasons for it. The Commission will in line with section 16 of Schedule 7 to the Ordinance, maintain a register of Decisions and notices of rescissions of Decisions made under Part 5 of Schedule 7 to the Ordinance.[11]

[10] The amount of fees chargeable is prescribed by a regulation made by the Chief Executive in Council.

[11] The Commission may omit confidential information from any entry made in the register; and where confidential information has been omitted, that fact must be disclosed on the register. The Commission must make the register available for inspection by any person (a) at the offices of the Commission during ordinary business hours; (b) through the Internet or a similar electronic network; and (c) in any other manner the Commission considers appropriate.

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5.18 Before deciding on an application for a Decision, section 12(1)(a) of Schedule 7 to the Ordinance requires that the Commission publish a notice of the application through the Internet or a similar electronic network and in any other manner the Commission considers appropriate. Under section 12 of Schedule 7 to the Ordinance, in order to bring the application to the attention of those the Commission considers likely to be affected by the Decision, the Commission must allow at least a period of 30 days for representations to be submitted, and consider any representations about the application that are made to the Commission.

5.19 According to section 11(3) of Schedule 7 to the Ordinance, the Commission is only required to consider an application for a Decision if:

(a) the application poses novel or unresolved questions of wider importance or public interest;

(b) the application raises a question of an exclusion under the Ordinance for which there is no clarification in existing case law or decisions of the Commission; and

(c) it is possible to make a Decision on the basis of the information provided.

Further, the Commission is not required to consider an application for a Decision if the application concerns hypothetical questions or conduct (section 11(4) of Schedule 7 of the Ordinance).

5.20 Any party who would like to apply for a Decision should complete Form M. Parties who have submitted information to the Commission when notifying a proposed merger for informal advice need only to provide such further information as required by the Form M[12] which has not already been provided. Where the application involves a proposed merger which is not yet in the public domain, the applicant must give consent to the Commission to publicise the proposed merger for inviting representations from the relevant parties pursuant to the statutory requirements (see paragraph 5.18 above), otherwise the application will not be processed.

[12] Please refer to paragraph 5.7 above.

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5.21 The time taken by the Commission to make a Decision on the application (where the application is accepted for meeting the requirements set out in paragraph 5.19) will depend very much on the nature and complexity of the transaction in question (including the volume of data required to be processed and the timeliness of their availability), and the resources available to the Commission at that point in time. The Commission will, however, endeavour to process applications in an efficient and timely manner with due regard being paid to the circumstances of the case.

5.22 The Commission may rescind a Decision if it has reason to believe:

(a) if the merger has not been carried into effect, that there has been a material change of circumstances since the Decision was made; or

(b) whether or not the merger has been carried into effect:

  (i) that the information provided by a person involved in the merger, on which it based its Decision was incomplete, false or misleading in a material particular; or

  (ii) that an undertaking has failed to observe any condition or limitation subject to which the Decision has effect.

5.23 Before rescinding a Decision, the Commission is required under section 15(3) of Schedule 7 to the Ordinance to publish a notice of the proposed rescission through the Internet or a similar electronic network and in any other manner the Commission considers appropriate in order to bring the proposed rescission to the attention of those the Commission considers likely to be affected by the proposed rescission, allow at least a period of 30 days for representations to be submitted, and consider any representations about the proposed rescission that are made to the Commission. If a Decision is rescinded, a notice of rescission will be issued to each undertaking specified in the Decision, informing them of the rescission and the reasons for it, the date on which the determination to rescind the Decision was made, and the date from which the rescission takes effect. Pursuant to section 15 of Schedule 7 to the Ordinance, each undertaking specified in the notice of rescission loses its immunity from action under the Ordinance, as from the date the rescission takes effect, with regard to anything done after that date.

5.24 Subject to the above, in considering and processing an application for a Decision for exclusion from the Merger Rule, the Commission will in general follow the procedures for processing an application for a Decision set out in *the Guideline on Applications for a Decision under Sections 9 and 24 (Exclusions and Exemptions) and Section 15 Block Exemption Orders*, to the extent where they are applicable.

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Investigation

5.25 As indicated in paragraph 5.1 above, under section 39 of the Ordinance, the Commission may conduct an investigation into a merger or an anticipated merger if it has reasonable cause to suspect that a contravention of the Merger Rule has taken place, is taking place or is about to take place. In relation to a completed merger, section 7 of Schedule 7 to the Ordinance states that an investigation may only be commenced within 30 days after the day on which the Commission first became aware, or ought to have become aware, that the merger has taken place. Under section 7(2) of Schedule 7 to the Ordinance, the Commission is to be taken to have become aware that a merger has taken place if it has been notified of the merger pursuant to this Guideline.

5.26 During an investigation, the Commission may in appropriate circumstances make use of the investigation powers conferred under the Ordinance to obtain evidence from the relevant parties. The Commission may also seek representations from the parties to a merger or an anticipated merger, and/or from relevant third parties, conduct market inquiries which could include consulting competitors of the merging parties, suppliers, customers, industry associations and consumer groups and consider their views in so far as they are relevant, and carry out independent research, for example to help assess the degree of competition in the relevant market.

5.27 If, after investigation, the Commission considers that there is no reasonable cause to believe that the merger or anticipated merger contravenes or is likely to contravene the Merger Rule (as the case may be), no proceedings will be brought and the Commission will take no further action.

5.28 The Commission will in general follow the *Guideline on Investigations*, to the extent where it is applicable, in conducting investigations.

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Proceedings before the Tribunal

5.29 If the Commission, after carrying out an investigation, has reasonable cause to believe that a merger or an anticipated merger contravenes, or is likely to contravene the Merger Rule (as the case may be), it may under sections 97 or 99 of the Ordinance bring proceedings before the Tribunal seeking orders to stop the contravention (which may, effectively, unwind a completed merger, or stop the process in relation to an anticipated merger). As required under section 99(2) of the Ordinance, for a completed merger, proceedings must be brought within the period of six months after the day on which the merger was completed or the Commission became aware of the merger, whichever is the later. This six month period may be extended by the Tribunal under section 99(3) of the Ordinance on the application of the Commission if the Tribunal considers it reasonable to do so.

5.30 Where proceedings are brought in relation to an anticipated merger under section 97 of the Ordinance, and before the Tribunal has finally determined on the matter, the Tribunal may, either of its own motion or on application by the Commission, make interim orders under section 98 of the Ordinance for the purpose of preventing pre-emptive action that might prejudice the hearing under section 97 or any final order that the Tribunal might make on the hearing of the application.[13]

Confidentiality and disclosure

5.31 Section 125 of the Ordinance imposes a general obligation on the Commission to preserve the confidentiality of any confidential information provided to or obtained by the Commission. Reference is made to the *Guideline on Applications for a Decision under Sections 9 and 24 (Exclusions and Exemptions) and Section 15 Block Exemption Orders* and *Guideline on Investigations* issued by the Commission, to the extent where they are applicable, for the Commission's approach in handling confidential information and its disclosure under the Merger Rule.

[13] Interim orders may include orders (a) prohibiting or restricting the doing of things that the Tribunal considers would constitute pre-emptive action; (b) imposing on any person concerned obligations as to the carrying on of any activities or the safeguarding of any assets; (c) providing for the carrying on of any activities or the safeguarding of any assets either by the appointment of a person to conduct or supervise the conduct of any activities (on any terms and with any powers that may be specified or described in the order) or in any other manner.

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Other Commission Procedures

5.32 Information provided voluntarily to the Commission by parties seeking an informal advice on a proposed merger or approaching the Commission for other purposes (such as for exploring possibilities of Commitments or applying for a Decision from the Commission that the merger is excluded from the Merger Rule), including information protected by legal professional privilege, will not be accepted on a "without prejudice" basis or otherwise on terms that its use is limited for the sole purpose of seeking an informal advice (or such other purposes as specified by the parties). The Commission can use any information so received, with or without notice to interested parties, for other purposes under the Ordinance. This includes for the purposes of considering whether a contravention under the Ordinance has occurred and/or with a view to enforcement where there has been a contravention.

5.33 As a general matter, parties to a merger are encouraged to seek legal advice before approaching the Commission seeking an informal advice on a proposed merger or for other purposes.

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